SCS Agency
Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Campbell	Analyst:	Marion Mann DeJong	Bill Number:	AB 1976
Related Bills:		Telephone:	(916) 845-6979	Amended Date:	05/14/98
		Attorney:	Doug Bramhall	Sponsor:	

SUBJECT: Manufacturers' Investment Credit/Excess Credit Refundable Over 5 Years

_____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _________.

_X_ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

_X_ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as amended May 5, 1998.

_____ FURTHER AMENDMENTS NECESSARY.

_____ DEPARTMENT POSITION CHANGED TO ________________________.

_X_ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED May 5, 1998, STILL APPLIES.

_____ OTHER - See comments below.

SUMMARY OF BILL

This bill would allow any excess Manufacturers' Investment Credit (MIC), including prior year carryovers, to reduce the taxpayer's current year tax liability, with any remaining balance to be refunded in five equal installments over the following five years. The bill would also declare the Legislature's intent to appropriate funds for the refunds.

SUMMARY OF AMENDMENT

The May 14, 1998, amendments changed the refund period from three years to five years. These amendments would spread the revenue loss over two additional years (see Tax Revenue Estimate below).

Except for the tax revenue estimate, the department's analysis of the bill as amended May 5, 1998, still applies. The Policy Considerations, Implementation Considerations, Technical Considerations and Departmental Costs from that analysis are reiterated below. An additional technical amendment is provided to delete the definition of "small business" since it was only relevant to the carryover period, which this bill would delete.

DEPARTMENTS THAT MAY BE AFFECTED:

____ STATE MANDATE ____ GOVERNOR'S APPOINTMENT

Board Position:	Agency Secretary Position:	GOVERNOR'S OFFICE USE
____ S ____ O ____ SA ____ OUA ____ N _X_ NP ____ NA ____ NAR ________ PENDING	____ S ____ O ____ SA ____ OUA ____ N ____ NP ____ NA ____ NAR DEFER TO ____________	Position Approved ____ Position Disapproved ____ Position Noted ____
Department/Legislative Director Date Johnnie Lou Rosas 5/27/98	Agency Secretary Date	By: Date:

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Policy Considerations

This bill would raise the following policy considerations.

- Critics of the current law MIC argue that the credit is useless since the taxpayer may not have sufficient tax liability within eight years (or ten years) to use the credit before the carryover is lost. This bill would resolve that concern by refunding the credit when there is not sufficient tax liability to use it. On the other hand, the MIC was enacted rather than a sales tax exclusion to reduce the overall cost of the tax benefit, since it was understood that credits frequently are not fully utilized.

- The 6% MIC offers a greater benefit than the 5% sales tax exclusion available to new businesses. In addition, it covers such items as capitalized labor on which no sales tax is paid.

- Historically, refundable credits (such as the state renter's credit, the federal Earned Income Tax Credit and the federal farm gas credit) have had significant problems with fraud.

Implementation Considerations

This bill would raise the following implementation considerations. Department staff is available to assist the author with any necessary amendments.

- The department has not administered a refundable tax credit under the PITL since the renter's credit was suspended in 1993. The department has never administered a refundable tax credit under the B&CTL. Establishing a refundable tax credit program would have a significant impact on the department's programs and operations and require extensive changes to forms and systems.

- Because of the complexity of the refund provisions and the potentially significant refund amounts, it is expected that the department would manually review the returns requesting refund installments before refunds are issued. However, since complete audits could not be conducted within the normal return processing time frames, refunds would be issued prior to audit. Disputes between taxpayers and the department could arise if upon audit (several years later) the taxpayer is asked to repay any incorrect refund amounts (with interest).

- It is unclear how the refund provisions would apply to estimated tax payments and underpayment of estimated tax penalties.

- Refunding the MIC over a five-year period increases the complexity of implementation, especially in the case of dissolving entities. Further, it is unclear whether the refund would be recaptured if the successor did not continue the manufacturing activity, ceased to use the qualified property in a qualified activity or removed the property from this state.

- Because of the use of the terms "net tax" and "tax," the MIC provisions (Sections 17053.49 and 23649) would require the taxpayer to utilize the MIC against tax ***before*** any other credits while the credit hierarchy provisions (Sections 17039 and 23036) would require the taxpayer to utilize the MIC against tax ***after*** certain other credits. The renter's credit uses the term "tax liability under this part" so that the renter's credit is used after other credits.

- Since this bill would delete the MIC carryover provisions and replace them with refund provisions, the department would consider the MIC to be a credit with only refundable provisions. However, since the MIC refund provision references prior year carryovers, taxpayers could consider the MIC to be a credit with both carryover and refundable provisions. This could cause disputes between taxpayers and the department, specifically in regards to the order of credits.

Technical Considerations

- Amendments 1 and 5 would delete the definition of "small business" since it was only relevant to the carryover period which this bill would delete.

- Amendment 2 would change "provision" to "provisions."

- Amendments 3 and 4 would modify the language that requires the Franchise Tax Board to determine the order of credits within each category to match the provisions of Section 17039. Amendment 3 would also change "taxable year" to "income year."

Departmental Costs

Based on a preliminary analysis of this bill, it is estimated that departmental costs for programming and systems changes to implement this bill would exceed $1 million for 1998-99. It is estimated that costs for processing refund requests and issuing refunds in the first year (1999-00) would be approximately $500,000, with ongoing annual costs of approximately $1 million per year beginning in 2000-01. This estimate does not include costs for processing and refunding prior year carryover amounts since data regarding the number of returns with prior year carryovers are not currently available. Department staff will refine and update these costs as the implementation considerations are resolved.

Tax Revenue Estimate

The projected revenue losses decreased from the losses estimated for the prior version of this bill since the May 14, 1998, amendments spread the refunds over five years rather than three years. The estimated revenue impact of this bill is shown in the following table:

AB 1976 As Amended May 14, 1998 Refunds for Tax Years Beginning on and After January 1, 1998 $ Millions			
1998-99	1999-00	2000-01	2001-02
($15)	($340)	($430)	($510)

This analysis does not take into account any change in employment, personal income, or gross state product that may result from this bill becoming law.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 1976
As Amended May 14, 1998

AMENDMENT 1

On page 13, strikeout lines 28 through 36 inclusive.

AMENDMENT 2

On page 19, line 35 strikeout "provision" and insert:

provisions

AMENDMENT 3

On page 19, strikeout lines 37 through 39 inclusive and insert:

to be carried over to offset the "tax" in succeeding income years.

AMENDMENT 4

On page 20, strikeout lines 5 through 8 inclusive and insert:

(6) Credits that contain refundable provisions but do not contain carryover provisions.

The order of credits within each paragraph shall be determined by the Franchise Tax Board.

AMENDMENT 5

On page 30, strikeout lines 11 through 19, inclusive.